STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Verizon North Inc. (f/k/a GTE North Incorporated) and Verizon South Inc. (f/k/a GTE South Incorporated)	:	
	:	**Docket No. 00-0812**
Petition seeking approval of Cost Studies for Unbundled Network Elements, Avoided Costs, and Intrastate Switched Access Services	:	

SUPPLEMENTAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION – REPLY ROUND

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The Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, and pursuant to Section 200.800 of the Commission's Rules of Practice, 83 Ill. Adm. Code 200.800, and pursuant to the Administrative Law Judge's (hereafter "ALJ's") Order of July 11, 2003, respectfully submits its Reply Brief on the ALJ's Issues List in the above-captioned matter.

As an initial matter, the Staff notes that Verizon appears to have lost sight in this proceeding of where the burden of proof lies.

There is no question that Verizon has the burden of proof in this proceeding. Section 51.505(e) of the FCC regulations provides that:

> An incumbent LEC must prove to the state commission that the rates for each element it offers do not exceed the forward-looking economic cost per unit of providing the element, using a cost study that complies with the methodology set forth in this section and Sec. 51.511.
>
> 47 CFR §51.505(e)

Likewise, state law is clear on the point; Section 9-201(c) of the Public Utilities Act[1] provides, in relevant part, that:

> In [a] hearing [convened to determine whether rates are just and reasonable], the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility.
>
> 220 ILCS 5/9-201(c)

Verizon does little to meet this burden. Its Initial Brief in this round consists essentially of naked assertions that ICM meets the applicable standards, followed by attempts to rebut – in, it has to be noted, an *initial* briefing round –

[1] Section 9-201 is applicable to telecommunications carriers such as Verizon that provide both competitive and non-competitive service. *See* 220 ILCS 5/13-101.

the other parties' positions. *See, e.g.,* Verizon SB at 2-4 (Verizon contends that the network modeled by ICM does not impede the provision of advanced services, but does little else). In fact, Verizon has failed to answer the chief question clearly at issue: whether ICM models a network that utilizes – as FCC rules clearly require – the "most efficient telecommunications technology currently available and the lowest cost network configuration[.]" 47 CFR §51.505(a)(2)(B)(1). As such, the Commission has no choice but to reject the model.

A. ICM does not model the correct copper loop lengths and resulting number of DLCs

Verizon remains unable to effectively explain away the fact that the ICM models a network that is vastly more technologically advanced, capable – and inefficiently expensive – than anything it intends to build. *See, generally*, Verizon SB at 2-7. Verizon nonetheless takes issue – to no avail, as it happens – with several of Staff's criticisms of ICM regarding the fact that ICM models a network that utilizes far too many DLCs.

By highlighting the vast technological gulf that exists between the network that ICM models and the network that Verizon has actually deployed or plans to deploy, the Staff is not urging the Commission to base UNE rates on embedded, as opposed to forward-looking, costs. Rather, the Staff makes this showing for several reasons.

First, Staff will underline the marked difference between what UNE purchasers would pay for, and what they would get, if ICM were to be used to

estimate Verizon's TELRIC costs. Verizon UNE customers would pay for a remarkably advanced, ubiquitously xDSL-capable network, but would get Verizon service, with no such capabilities. CLECs should get the network features that they are paying for; were ICM to be adopted, they would not

Second, the Staff assumes that Verizon has the incentive to actually deploy what it considers to be the most efficient, least cost technology in its own network. By demonstrating the difference between the technology that Verizon actually plans to deploy on the one hand, and what ICM theoretically deploys on the other, the Staff will show that Verizon's view of what constitutes most efficient, least cost technology depends entirely upon who is paying for it. Where CLECs pay, expensive (although non-existent) NGDLCs are deployed in redundant droves. When Verizon pays, however, such a network is "unduly economically burdensome." *Joint Verified Petition of Verizon North, Inc. and Verizon South, Inc.*, ¶10, Verizon North, Inc. and Verizon South, Inc.: Verified Petition for Certification Pursuant to Section 13-517(a) or Waiver Pursuant to Section 13-517(b), ICC Docket No. 02-0560 (August 30, 2002) (hereafter "Waiver Petition").

Verizon states that the purpose of ICM is "not to replicate Verizon's existing network, but rather to model a network that best calculates Verizon's costs on a forward-looking basis." Verizon SB at 3. The Staff might recommend acceptance of ICM if it did any such thing. Regrettably, it does not.

First, the ICM should model not the costs *Verizon* would incur, but rather the costs a *theoretical "most-efficient" ILEC* would incur. As the FCC noted in its *First Report and Order*:

> [T]he forward-looking economic cost for interconnection and unbundled elements would be based on the most efficient network architecture, sizing, technology, and operating decisions that are operationally feasible and currently available to the industry. **Prices based on the least cost, most efficient network design and technology replicate conditions in a highly competitive marketplace by not basing prices on existing network design and investments unless they represent the least cost systems available for purchase.**
>
> **…**
>
> [P]rices for interconnection and access to unbundled elements would be developed from a forward-looking economic cost methodology based on the most efficient technology deployed in the incumbent LEC's current wire center locations. This approach mitigates incumbent LEC's concerns that a forward-looking pricing methodology ignores existing network design… Moreover, this approach encourages facilities-based competition to the extent that new entrants, by designing more efficient network configurations, are able to provide the service at a lower cost than the incumbent LEC.
>
> **…**
>
> We, therefore, conclude that the forward-looking pricing methodology for interconnection and unbundled network elements should be based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements.

First Report and Order, ¶¶672, 683, 685, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98 and 95-185, FCC 96-325, 11 FCC Rcd 15499; 1996 FCC LEXIS 4312; 4 Comm. Reg. (P & F) (August 8, 1996 Released; Adopted August 1, 1996) (hereafter, "First Report and Order"); *see also* 47 CFR § 51.505 (findings of the *First Report and Order* in this regard codified) (emphasis added)

Thus, *Verizon's* costs are not strictly at issue in this undertaking. Instead, the ICM should calculate the costs a maximally efficient ILEC would incur, were it saddled with Verizon's existing wire centers. To the extent that the ICM fails to do this – and Verizon seems to concede that it calculates *Verizon's* costs instead of those of a maximally efficient ILEC – the Commission should reject the model for failure to comply with the most basic TELRIC principles.

Moreover, ICM does not even meet the considerably less stringent standard of properly estimating the costs *Verizon* will incur. Verizon's "mission statement" for ICM states that it effectively models Verizon's forward-looking costs. Implicit in this statement is the proposition that Verizon actually *intends* to deploy the forward-looking technology that the ICM presupposes. However, as the Staff has observed elsewhere, Staff SB at 8, *et seq.*, this is the purest fantasy; Verizon has no intention of deploying a DSL capable forward looking network, and has stated in filings before this Commission that requiring it to deploy an 80% DSL capable network as required by Section 13-517(a) of the Public Utilities act, 220 ILCS 5/13-517(a), would cost the company $329 million, and would therefore be "unduly economically burdensome." Waiver Petition, ¶10.

As Staff has noted above, this fact remains valid and central to this proceeding: Verizon wants to charge – and ICM models costs that would permit it to charge – UNE rates that reflect a remarkably advanced, if inefficiently configured, network with ubiquitous xDSL capability, while in fact providing UNEs that are incapable of anything but plain vanilla Verizon service.

Verizon asserts that Staff witness Robert F. Koch does not provide any evidence to support his conclusion that ICM models a network that utilizes far too many DLCs. Verizon SB at 5-6. This contention simply does not square with the facts. As Mr. Koch noted in testimony, ICM models more DLCs than are in the existing network, and cannot be configured to model fewer DLCs. Staff Ex. 1.1 at 9. Likewise, Mr. Koch concurred with IRCA witness Jason Hendricks' observation that DLCs in the network modeled by ICM are designed to service customers at well under their capacity, and are hence inefficient and redundant. Staff Ex 1.1 at 15-16.

These factual criticisms go directly to the heart of the matter at issue. The ICM is designed in such a way that it models excessive numbers of expensive and inefficiently placed DLCs, and cannot be configured to model fewer. This alone is sufficient to warrant Commission rejection of ICM.

Verizon next criticizes Mr. Koch's analysis by asserting that the Illinois Cost of Service Rules dictate that forward-looking costs be developed utilizing the assumption that the service in question is being offered for the first time. *See* Verizon SB at 6; *see also* 83 Ill. Admin. Code 791.20(c).

Staff first observes that the Illinois Cost of Service Rules, *see, generally,* 83 Ill. Admin. Code 791.10 *et seq*., concern themselves with the calculation of Long Run Service Incremental Cost (LRSIC), a retail cost, instead of the wholesale TELRIC costs at issue here, and the question of whether the Cost of Service Rules apply here at all is therefore an open one. Staff notes that the Commission has, in at least one previous UNE case, stated that "[w]e are

unwilling to conclude that the process of establishing TELRIC based prices for UNEs represents such a unique activity that it renders the existing cost of service rules codified at 83 Ill. Adm. Code 791 irrelevant in this proceeding." *Second Interim Order* at 32; Investigation into forward looking cost studies and rates of Ameritech Illinois for interconnection, network elements, transport and termination of traffic, ICC Docket Nos. 96-0486 / 96-0569 (consol.) (February 17, 1998)(hereafter "TELRIC Order"). Thus, there is perhaps some basis for applying the Cost of Service Rules to certain discrete aspects of UNE rate development. The Commission did so in the *TELRIC Order* with respect to fill factors. TELRIC Order at 32 *et seq*.

Nonetheless, Verizon's assertion that TELRICs should be developed on the assumption that the "service" – again, a retail term in the context of Section 791.20(c) – is being offered for the first time is, at best, a curious one. The Staff assumes that Verizon means by this that a properly modeled network is one that is, to use Verizon's own terminology, "built from scratch", *ab initio*. Verizon SB at 2. Assuming that this is the case, Verizon's assertion is incorrect. The federal standards are clear:

> The total element long-run incremental cost of an element should be measured based on the use of the **most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers.**
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> 47 CFR §51.505(a)(2)(B)(1); *see also,* First Report and Order, ¶685

Thus, it is difficult to see how Section 791.20(c) applies in this context. It clearly varies from the federal standard, which requires the assumption of existing wire centers.

Verizon's reliance on Section 791.20(c), moreover, depends completely on the premise that the reader will ignore most of the specific language of the Section, which provides, in relevant part, that:

> [Forward-looking costs] shall be calculated as if the service were being provided for the first time **and shall reflect planned adjustments in the firm's plant and equipment. Forward-looking costs … are based on the least cost technology currently available** whose cost can be reasonably estimated based on available data[;] as such forward-looking cost estimates must reflect assumptions and technologies that are currently operational, that is, able to be used and available in the marketplace.
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> 83 Ill. Admin. Code 791.20(c) (emphasis added)

Thus, ICM fails to satisfy Section 791.20(c), and fails dismally. What it in fact does is model adjustments to Verizon's plant and equipment, and extraordinarily costly ones at that, which Verizon has, as a matter of public record, no intention whatever of making in the near future. Verizon does not plan to install numerous NGDLCs in its service territory, and does not plan to make its network 100% xDSL-capable; as noted above, it has obtained a waiver of its obligation to render its network *80%* DSL capable. Likewise, ICM models the most-cost technology, replete with NGDLCs that do not exist in most of Verizon's network, will not exist throughout Verizon's network over any reasonable planning horizon, and are not efficiently sited. In other words, ICM resembles a Soviet five-year plan; it makes economic projections that assume events that have precisely no chance of occurring.

Further, Verizon's invocation of the Revised Resistance Design (RRD) standard is a red herring. Verizon notes that its 18kFt copper loop restriction permits data "speeds slower than 6 mbps," and coyly observes that this configuration "remains consistent" with the RRD standard. Verizon SB at 3. What it does not note is the fact that many other – and lower cost – configurations may also do the same, with fewer DLCs. Consequently, it cannot be said that ICM models a least-cost network, nor can it be made to, since, as noted above, ICM cannot be configured to model fewer DLCs. Staff Ex. 1.1 at 9. It is in any case impossible to determine from Verizon's Brief, or from witness David Tucek's testimony, precisely how *much* slower than 6 mbps the speeds permitted by the 18kFt copper loop restriction are, although Mr. Tucek notes that the 18kFt copper loop restriction permits "some form of advanced data services – though not those requiring 6 mbps[.]" Verizon Ex. 2.0 at 16.

Thus, the ICM-modeled network – in both of its potential configurations – takes a marked departure from reality. Section 13-517, from which Verizon has sought and obtained a waiver, defines advanced telecommunications services as "capable of supporting, in at least one direction, a speed in excess of 200 kilobits per second (kbps)[.]" 220 ILCS 5/13-517(c). Thus, both modeled networks – the network modeled by the "as filed" ICM, and the network modeled by the 18kFt copper loop restriction ICM – have ubiquitous capabilities that Verizon's actual network does not have, and will not have in the near future. To put this in some sort of perspective, Verizon's Brief states "[a]s filed, ICM models a … 6 mbps copper loop network that does not impede the provision of advanced services."

Verizon SB at 3. A 6 mbps copper loop network is, of course, a loop capable of data speeds 30 times faster than the 200 kbps loops that Verizon sought and obtained a waiver of its statutory obligation to build. ICM therefore models a network that is *orders of magnitude* more capable than anything that will exist in Verizon territory over any realistic planning horizon. The Commission should not require Verizon's competitors to pay for this. This is especially true in light of FCC regulations, which provide in relevant part that:

> The total element long-run incremental cost of an element is the forward-looking cost over the long run of the total quantity of the **facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element**, calculated taking as a given the incumbent LEC's provision of other elements.
>
> 47 CFR §51.505(b) (emphasis added)

It is impossible to conclude reasonably that an extensive network of NGDLCs – which differ from less expensive traditional DLCs largely by virtue of the fact that xDSL service can be provided over them – are somehow "facilities … directly attributable to, or reasonably identifiable as incremental to, [the provision of an] element[.]" The fact remains, inconvenient though it may be, that Verizon itself has no intention of providing ubiquitous xDSL service, there is no evidence that Verizon's network is actually capable of providing ubiquitous xDSL service, and there is no reason why Verizon's competitors should have to pay for more expensive UNEs based upon the materially false proposition that the network is capable of providing ubiquitous xDSL service. If Verizon's competitors could use the UNEs in question to provide xDSL, it would perhaps be another

matter. However, at this point, Verizon's attempt to charge competitors for theoretically xDSL capable UNEs runs well afoul of the FCC rules.

Verizon asserts that Mr. Koch's observation that the number of DLCs overstates costs does not hold up when compared to the actual facts in the record. Verizon SB at 6-7. This, too, is at odds with the facts. *See* Staff Ex. 1.1 at 10-11. Verizon's argument is a red herring. If ICM models an inefficient network, whether its output is above or below the theoretical replacement cost calculated by Mr. Tucek, is immaterial. If the modeled network is inefficient, it is not TELRIC compliant. Moreover, FCC rules absolutely prohibit the use of embedded costs in the determination of UNE rates. *See* 47 CFR §51.505(d)(1) ("[Embedded costs] shall not be considered in a calculation of the forward-looking economic cost of an element[.]"); *see also* First Report and Order, ¶¶ 704-707.

Moreover, Mr. Tucek's calculations are entirely speculative. Staff Ex. 1.1 at 10. The calculations provided by Mr. Tucek rely on broad assumptions and speculation for their derivation. As such, these numbers are not valuable in any analysis.

Verizon contends that the use of NGDLC throughout the network is appropriate. Verizon SB at 7. This, however, cannot be justified. NGDLC equipment is used to provide xDSL service, with which traditional DLCs are not compatible. Thus, in a network that does not, and will not at any point in the foreseeable future, have such capabilities, the ubiquitous use of NGDLCs is not the least-cost, most efficient technology. Rather, there is traditional DLC

equipment available that is more prudent. Verizon has the burden – unmet as of this pleading – to show that it is appropriate to model the NGDLC equipment throughout the network. To do so Verizon must show that advanced services are being provisioned now throughout the network, or might be provisioned in the near future. The only semblance of evidence is a statement that the GR-303 interface in ICM allows for greater concentration on the DS-1 links that connect the DLC to the central office. *See* Verizon SB at 7. Although this sounds like an appealing characteristic of the equipment, Verizon has not shown how using such technology leads to a lower cost per loop. As such, the Commission should reject ICM, based on the model's demonstrated failure to model a least-cost, most efficient network.

Verizon implies that Staff proposes the use of "backward-looking" technology in ICM. Verizon SB at 7. In fact, Staff recommends no such thing. Verizon points to Mr. Koch's mention of SLC-96 as an example of a traditional DLC in his rebuttal testimony. Verizon SB at 7. In doing so, Verizon misinterprets Staff's position. Staff is merely pointing out that a more traditional DLC system would be more efficient in certain areas, rather than using cutting-edge technology throughout. By restricting its criticism to SLC-96 systems, Verizon is able to point to deficiencies in one possible alternative to NGDLCs, and thereby avoid the vexing question of whether its choice is necessary.

The Commission should reject ICM. It models an overbuilt, gold-plated, excessively costly – but inefficient – network that could scarcely be more different from the workaday network that actually exists and will continue to exist

throughout Verizon territory for the foreseeable future. ICM simply does not satisfy TELRIC rules.

B. It is improper for ICM to model two separate local loop networks

Verizon notes that "Staff witness Zolnierek criticizes ICM's two network approach stating that the wholesale network results in a greater level of modeled investment than does the retail configuration" then alleges that "[t]his is incorrect." Verizon SB at 9. Verizon is quite wrong in this assertion. Dr. Zolnierek's statement is correct. In the paragraph immediately following its allegation, Verizon states "Mr. [sic] Zolnierek is correct that the wholesale-modeled investment is greater than that of the retail configuration...[.]" Id. Verizon has, it seems, confused a disagreement over *interpretation* of a fact with disagreement over the *fact itself*. The *fact itself* is precisely as Dr. Zolnierek stated it – that the wholesale-modeled investment produced by the ICM is *greater* than that of the retail configuration.

Verizon also appears to be confused regarding the proper interpretation of this undoubted fact. Verizon states that the difference between the wholesale-modeled and retail-modeled investment is not material and alleges: "Mr. [sic] Zolnierek ignores this point." Verizon SB at 9. Verizon's characterization entirely overlooks the fact that Staff has clearly and explicitly responded to its concern. *See* Staff Reply Brief at 19.[2]

[2] Indeed, Staff considered the possibility that there might be some merit in Verizon's assertion. *See* Staff Reply Brief at 19 ("Staff believes there is some merit in the position that a cumulative difference of 0.5% (in total modeled investment) may be insufficient to justify the additional correction, particularly as further complexity may create additional problems.")

Verizon asserts that, "the record demonstrates that both the unbundling requirements for a loop and the cost implications of utilizing a separate network approach outweigh Mr. [sic] Zolnierek's imagined defect." Verizon SB at 10. Next, to support its position Verizon argues:

> ICM models the cost of an unbundled loop by assuming the UDLC configuration for all loops. This assumption produces a lower cost estimate because it takes advantage of the already existing fiber link between the DLC and the office, thereby eliminating the cost of any copper feeder facilities that might actually be used. The estimated costs are also lower because ICM assumes the maximum possible fill on the COTs in the wire center.
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> Verizon SB at 8.

Thus, to support its position that its estimates are not defective, Verizon argues that the results are incorrect, albeit in a direction that might work against Verizon's interests. Again, Verizon has failed to apprehend a basic fact. It is indisputable that Verizon's estimation methodology, which examines separate wholesale and retail networks rather than a single unified network, does not accurately reflect Verizon's costs—either actual or forward-looking.

In its Reply Brief, Staff stated that, "Verizon's approach will, in theory, produce higher fill factors than an approach which models a single dual-purpose network with the respective wholesale and retail type configurations used by Verizon" and "... there is some merit in the position that a cumulative difference of 0.5% (in total modeled investment) may be insufficient to justify the additional correction, particularly as further complexity may create additional problems. Staff Reply Brief at 19. In fact Staff indicated "[i]n sum, despite the shortcomings in Verizon's position, Staff accepts Verizon's approach to generate switch

investment." Staff Reply Brief at 19. It is unclear why Verizon elects to ignore Staff's position with respect to its dual modeling approach, particularly when Staff has offered conditional support for Verizon's approach. Staff can only surmise that Verizon ignores Staff's position because Verizon has failed to address Staff's remaining objection to ICM – that it does not accurately model costs.

With respect to accuracy, Staff noted, "that [the two-network] approach may influence the allocation of shared and common costs between wholesale and retail products and services." Staff Reply Brief at 19. Verizon has not offered any credible evidence that demonstrates that its two separate models result in a *reasonable* shared and common cost allocation and, in particular, that its modeling short cut has not resulted in double recovery of shared and common costs. Absent this evidence, Staff reiterates its position "that a necessary condition of acceptance of Verizon's model be that the model be modified so as to produce a single network and a single set of costs consistent with that network." Staff SB at 15.

Accordingly, the Commission should reject ICM.

C. ICM is somewhat flexible but not readily open to inspection and testing

Verizon asserts that:

> Staff witness Zolnierek's proposed standard for gauging the flexibility and openness of ICM is also flawed. While he correctly identifies the three basic ways that a user can alter the ICM, he implies that the third method – modification of ICM's code – is not satisfactory and that any change ordered by the Commission must be accomplished by changing the model inputs.

Verizon SB at 14.

This is simply not the case. As Staff stated in its Reply Brief:

> Verizon has mischaracterized Staff's position with respect to the modification of ICM's code. As Staff has made clear in both testimony and in its initial brief, if Verizon is able to correct ICM's modeling deficiencies, Dr. Zolnierek has testified that he will reanalyze the company's switched access cost estimates and alter his recommendations accordingly. Staff Ex. 2.0 at 3. Dr. Zolnierek explicitly testified, "…the ultimate flexibility of the model depends on whether Verizon can make Commission-ordered changes in assumptions by merely manipulating run time options screens or data tables used as inputs into the ICM, or whether such changes require fundamental reprogramming of the model." Staff Ex. 2.1 at 13. Staff's position is clear and unambiguous. If Verizon can overcome any inflexibility in the model and remedy the deficiencies Staff has identified, then Staff will reevaluate the model methodology and revise its recommendations accordingly. There is no issue here of setting an "impossible standard", as Verizon asserts.

Staff RB at 5.

Verizon's response to Dr. Zolnierek highlights why the Commission must clearly identify what it is and is not approving in this phase of the proceeding. Verizon is requesting the Commission approve its ICM model. *See* Verizon IB at 7 ("[A]t a minimum, the Commission should approve ICM in Phase I of this proceeding.") Verizon requests that the Commission approve the ICM model, notwithstanding significant recoding that is necessary.

For example, in the event that the Commission determines that ICM should be designed to accept Vendor cost information *directly*, rather than accepting the information filtered through SCIS and COSTMOD, the Commission is effectively ordering a fundamental change in the model. In fact, an alteration in this manner and to this extent would essentially have the effect of preventing revisions to the model for purposes of directing the input of its pricing estimates.

As Verizon itself notes, "[t]here is no alternative to the approach that Verizon has taken with ICM which is to obtain pricing for a set of model office clusters and use this pricing to develop the SCIS and CostMod discount inputs." Verizon IB at 69. Contrary to Verizon's assertions, Verizon IB at 6-7, 69, this is not a problem related to the model's *inputs*. Rather it is a problem with the ICM itself. Effectively, this alteration creates a model different from the ICM. Accordingly, Verizon cannot colorably assert that the Commission should approve the model if the Commission finds that recoding is required.

Verizon's arguments imply that, as long as the ICM can be modified to accommodate regulated changes, ICM is flexible and should be accepted. Assuming for the sake of argument that this is true, it is of little relevance to this proceeding. Presumably, with enough coding and input changes, Verizon's ICM model could be made to estimate the cost of tea in China, the number of angels that can successfully dance on the head of a pin, or the likelihood of a Chicago Cub World Championship. The fact that coding changes are necessary at all indicates a lack of flexibility. Verizon is requesting that the Commission approve the collective assumptions and associated algorithms that Verizon calls the ICM model. Staff has demonstrated that a number of these assumptions and algorithms are deficient and result in improper cost estimation. Thus, the Commission should be clear that Staff urges rejection of the ICM model but will reevaluate a model (by whatever name) that corrects the deficiencies identified by Staff.

Despite Staff's clarification in direct response to Verizon's concern, Verizon continues to mischaracterize Staff's position: thereby again causing confusion regarding a basic fact in this proceeding.

Verizon offers as additional evidence of the viability of its model the fact that it has provided other parties access to its source code, an action Verizon claims exceeds the standard established by the Florida Public Service Commission. Verizon SB at 14. In this assertion, Verizon errs. Verizon's provision of the source code of its model is a *necessary* condition for approval of its model. However, it is not *sufficient* condition for approval. For example, if Verizon were to provide the source code for Pong,[3] Staff would not recommend that the Commission approve Pong as an appropriate UNE cost model, unless, to everyone's surprise, Pong proved able to estimate forward-looking costs in a manner consistent with TELRIC principles.

Again, Verizon has simply failed to meet its burden. ICM must be rejected.

D. The Commission should adopt FCC proxy rates

As Staff noted in its Supplemental Brief, Section 51.513(a) of the FCC administrative rules provides that:

> A state commission may determine that the cost information available to it with respect to one or more elements does not support the adoption of a rate or rates that are consistent with the requirements set forth in Secs. 51.505 and 51.511. In that event, the state commission may establish a rate for an element that is consistent with the proxies specified in this section, provided that:

[3] Pong, for the younger reader, was one of the first video games ever produced, permitting players to engage in a rather sedate version of two-dimensional ping-pong.

> (1) Any rate established through use of such proxies shall be superseded once the state commission has completed review of a cost study that complies with the forward-looking economic cost based pricing methodology described in Secs. 51.505 and 51.511, and has concluded that such study is a reasonable basis for establishing element rates; and
>
> (2) The state commission sets forth in writing a reasonable basis for its selection of a particular rate for the element.

47 CFR §51.513(a)

Staff, in its Supplemental Brief, argued for the adoption of such proxy rates. *See* Staff SB at 32 *et seq*. Despite Verizon's assertions to the contrary, the Staff continues to recommend adoption of the proxy rates.

Verizon first argues that it has rates in effect, through its interconnection agreement with AT&T. Verizon SB at 17. The Staff notes that UNE rates set in late 1996 are now approaching senescence, and most efficient, least-cost-producer costs have fallen. Likewise, there may be elements a potential competitor finds necessary or desirable for which rates were not set under the AT&T agreement.

Verizon states that "[t]he Commission has already determined [in the AT&T – GTE arbitration] that the FCC's proxy rates should not be used *even when there are no rates in effect*." Verizon SB at 19 (emphasis in original). This is a questionable reading of the Commission's ruling, which is, in it entirety, as follows:

> Commission Conclusion
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> In light of our decision to utilize Staff's wholesale pricing methodology in Issue 1, there is no need to utilize the FCC proxy. However, the Commission recognizes that GTE will not be able to implement Staff's pricing methodology until Docket 96-0503 is completed. Therefore, we

> adopted Staff's recommendation that GTE's wholesale discount rates be set equal to the discounts of Ameritech Illinois in Docket 95-0458 et al., Consol. In situations where GTE offers a service that does not correspond to that offered by Ameritech Illinois, then GTE should apply the average Ameritech Illinois wholesale discount[,] which is currently equal to 17.5 percent.
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> *Order* at 17 (Lexis® pagination), AT&T Communications of Illinois, Inc: Petition for Arbitration of Interconnection Terms, Conditions and Prices from GTE North Incorporated [and GTE South Incorporated, in their respective services areas], ICC Docket No. 96-AB-005, 1996 Ill. PUC LEXIS 699; 173 P.U.R.4th 486 (December 3, 1996)

This is scarcely the ringing Commission rejection of the FCC proxy rates that Verizon represents it to be. Rather, the Commission found that, having adopted a rate-setting methodology, and having other recently established rates conveniently available, there was not a need to adopt the proxy rates. Here, of course, the existing rates are approaching seven years old.

Verizon further argues – futilely, in light of the TELRIC standard – that the Commission cannot adopt the FCC proxy rates because they do not "correspond to Verizon's costs." Verizon SB at 19. In the same vein, Verizon contends that, prior to the Commission setting rates, "a utility is required to present information to support its own costs for the provision of service in order to recover such costs in its revenue requirement[,]" for which proposition it cites as authority Code Part 285. Id. at 18.

Verizon appears, yet again, to have failed to properly comprehend the TELRIC standard. Code Part 285 is a set of administrative rules applying to rate-of-return proceedings. *See* 83 Ill. Admin. Code 285.110 ("The Standard Filing Requirements [in this Code Part] are designed to assist the Commission in

performing a review of filings for base rate increases under Section 9-201 of The Public Utilities Act[.]") As Staff notes elsewhere, revenue requirements, embedded costs, and rate-of-return regulation in general, cannot be used as a basis for TELRIC costs. 47 CFR §51.505(d)(1); First Report and Order, ¶¶ 704-707. Likewise, the TELRIC standard does not concern itself with Verizon's costs; rather, it concerns itself with the costs that would be incurred be a maximally efficient least-cost provider using Verizon's wire centers.

Verizon next argues that the Commission has no authority to set interim rates without a hearing, which it states has not taken place here. Verizon IB at 18. This assertion regarding the limits of Commission authority is incorrect.

First, as noted above, to invoke the FCC proxy rates, the Commission need not convene a hearing at all. Under authority conferred by FCC rules – and by extension, by the 1996 federal Telecommunications Act – the Commission need only "set[] forth in writing a reasonable basis for its selection of a particular rate for the element." 47 CFR §51.513(a)(2). The Commission can certainly meet this rather modest standard in its Phase I Order in this proceeding.

Second, Verizon is attempting to construct elaborate procedural requirements under Section 13-501(b) where none exist. Section 13-501(b) provides that:

> After a hearing, the Commission has the discretion to impose an interim or permanent tariff on a telecommunications carrier as part of the order in the case. When a tariff is imposed as part of the order in a case, the tariff shall remain in full force and effect until a compliance tariff, or superseding tariff, is filed by the telecommunications carrier and, after notice to the parties in the case and after a compliance hearing is held, is found by the Commission to be in compliance with the Commission's order.

220 ILCS 5/13-501(b)

In the past, the Commission has not interpreted its authority to impose an interim tariff under Section 13-501(b) nearly so narrowly as Verizon now advocates. In the SBC *TELRIC II* proceeding, the *Order on Rehearing*, which imposed an interim tariff, was based upon very cursory hearings. *See Order on Rehearing* at 8-9, 78-79, (Lexis® pagination), Illinois Commerce Commission On Its Own Motion: Investigation into the compliance of Illinois Bell Telephone Company with the order in Docket 96-0486/0569 Consolidated regarding the filing of tariffs and the accompanying cost studies for interconnection, unbundled network elements and local transport and termination and regarding end to end bundling issues, ICC Docket No. 98-0396, 2002 Ill. PUC LEXIS 482 (April 30, 2002). It is difficult to conclude here that Verizon has in any way suffered a lack of due process if the Commission rejects its cost model and imposes FCC proxy rates. Certainly, the Commission has a satisfactory record before it to reject ICM, and impose proxy rates.

Finally, Verizon notes that the parties agreed to trifurcation of this proceeding, and thus implicitly agreed that rate setting would not take place in this phase. This, while correct, does not fully account for changed circumstances resulting from passage of time. The agreement in question dates from March of 2001, Tr. at 5, and was made on the belief – at least on Staff's part -- that Phase I would be concluded long before this[4]. Proxy rates, which may have been

[4] Staff does not suggest that Verizon has been dilatory in this proceeding. The delays in this proceeding can be laid at the door of almost all the parties; Staff itself requested an extension in this proceeding two weeks ago.

unnecessary in 1996, and premature in the winter of 2001, are a good idea here in the summer of 2003.

Second, Staff is informed and believes that Verizon intends to introduce a new cost model that will supersede ICM. This being the case, it seems likely that the goal of final UNE rates will take even longer to reach. This, too, argues for adoption of proxy rates.

Nonetheless, Staff is sympathetic to Verizon's concerns regarding proxy rates, and, to the extent that a schedule can be adopted in Phase II calculated to result in a prompt Phase II Commission Order, this would go far to remove the need for proxy rates and thereby satisfy Staff. However, at present, Staff sees no alternative to proxy rates, and urges their adoption.

WHEREFORE, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in their entirety consistent with the arguments set forth herein.

Respectfully Submitted,

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